Charnwood

HOUSING MANAGEMENT ADVISORY BOARD

To: Councillors Ali, Davis, Edwardes (Chair), Hudson, Riley (Vice-Chair), Wright, Radford and Seaton (For attention)

All other members of the Council
(For information)

You are requested to attend the meeting of the Housing Management Advisory Board to be held in the Preston Room, Woodgate Chambers, Woodgate, Loughborough on Wednesday, 10th November 2021 at 4.30 pm for the following business.

Chief Executive

Southfields
Loughborough

5th November 2021

AGENDA SUPPLEMENT

HOUSING MANAGEMENT ADVISORY BOARD

Report of the Head of Landlord Services

ITEM 4 DRAFT HOUSING REVENUE ACCOUNT (HRA BUSINESS PLAN) 2021-2052 AND ASSET MANAGEMENT STRATEGY FRAMEWORK

Purpose of Report

To consider the draft updated Housing Revenue Account (HRA) Business Plan 2021-2052 and Asset Management Strategy Framework.

Recommendation

That the Board consider, comment, and endorse the draft updated Housing Revenue Account (HRA) Business Plan 2021-2052 and Asset Management Strategy Framework attached at Appendix 1 and 2 respectively.

Background

In February 2012 Cabinet recommended to Council approval of a 30-year HRA Business Plan required to deliver the self-financing requirements introduced by the Localism Act 2011. This was approved by Council on 27th February 2012 (minute 75.5). It was also resolved that the Business Plan would be periodically reviewed and updated.

On 25th September 2014 (Minute 35) Cabinet approved the HRA Business Plan 2014-2044 and Housing Asset Management Strategy 2014-19.

Asset Management Strategy Framework

The draft Framework sets out the Council's proposed approach to updating the 2014 Asset Management Strategy, ensuring it links to our priorities, and highlights risk and opportunities around our HRA assets, including homes, estates, sheltered accommodation, shops, and garages.

The framework identifies several key actions to be completed over the coming months, including a 20% representative stock condition survey. This will involve a survey of properties to check the condition matches the information held about them on the Council's systems. The survey will also look at the energy efficiency of properties. This action will support validation of the assumptions in the HRA Business Plan. It is expected that an updated Asset Management Strategy will be brought forward in 2022, which in addition to setting out how the assets will be maintained, will outline the approach to key potential areas of investment including:

- Sheltered housing improvements
- Decarbonisation / energy efficiency
- Stock replacement e.g., new build and acquisition of properties
- Regeneration and estate improvement

HRA Business Plan 2021-2052

The draft Plan 2021-2052 identifies the level and sources of funding available to deliver our priorities and provide the housing service to tenants and leaseholders. It is a long-term plan covering the next 30 years.

The Plan starts in April 2021 as 2021 data has been used to develop it. The Plan is subject to changes in the 2022/23 budget and 2021/22 out-turn process and the results of any future revisit to investment standards.

The Plan updates the previous HRA Business Plan approved in September 2014, reviewing, and updating investment, income, and expenditure assumptions. The financial modelling in the Business Plan has been carried out by Savills UK.

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Asset Management Strategy Framework

1. Introduction

The Council has invested over £44 million in its stock over the life of the 2014 Asset Management Strategy to deliver the Charnwood Standard of accommodation, which aims to exceed the government set Decent Homes Standard.

This framework sets out the Council's proposed approach to updating the 2014 Asset Management Strategy, ensuring it links closely to our objectives, and highlights risk and opportunities around our HRA assets.

Alongside this framework, the Council is currently changing its model for the delivery of planned investment, moving away from delivery of multiple workstreams though a single managing contractor, to a model based on delivery though multiple dedicated specialist contractors.

The reason for creating a framework as opposed to immediately updating the existing strategy is threefold:

- Firstly, the amount of change that the Council, and the housing sector more generally, faces around stock investment and asset management. These changes are outlined in the context section of this document. Whilst the purpose of our asset management strategy remains largely consistent, the changes will result in some key decisions for the Council.

- Secondly, the Council is considering improvement expenditure – predominately focused on its sheltered housing schemes but also including estate-based improvements - and wants to ensure that the capacity to make this investment is fully understood.

- Thirdly, the Council requires additional information to be sure that the HRA Business Plan accurately captures investment requirements and that it can properly evaluate stock investment decisions and make appropriate recommendations to stakeholders.

Whilst the information supporting the existing AMS and the associated HRA Business Plan has served its purpose, we now need to ensure that we can continue to make informed decisions around asset investment and do not want to increase risk by bringing forward a strategy without the necessary foundations.

This framework sets out key objectives and an outline approach to asset management. It also includes some commentary on where we currently are against the framework and identifies some key immediate actions. This will develop into a more detailed action plan that identifies the work that needs doing to develop and implement the strategy.

2. Approach and Timetable

The approach to the development of the strategy will be to take the existing information that we have available - including updated stock condition survey report and energy study, and the latest information on fire/building safety as outlined below - and validate this to compare the current cost forecasts from these activities with the current HRA Business Plan allowances. We will then produce a draft strategy setting out a prioritised plan of what is affordable within the existing allowances. We will bring forward a draft updated strategy for discussion by the end of Quarter 2 of 2022/23 on this basis.

It is important to note that this approach will aim to produce a strategy that is affordable within the existing HRA Business Plan that accompanies this paper. If the updated cost forecasts arising from the exercise to interrogate and validate our existing information varies materially from those contained within the current plan, we will be clear what is deliverable within the existing plan and the subsequent impact on the housing stock and our plans to invest in improvement expenditure. The updated draft strategy will then allow further debate prior to approval.

This framework sets out the tools needed to develop the strategy. These are split into two phases. Firstly, the work needed to validate existing stock condition data and develop an affordable strategy as described above. This will be delivered prior to strategy approval to give stakeholders the necessary assurance that the strategy is robust. Secondly, the work needed to further develop and implement the strategy and the asset performance evaluation that will consider the long-term contribution of the assets.

Scope
The strategy will set out our overall approach to asset management of the HRA stock. It includes all our housing assets, including sheltered accommodation, and other HRA assets including garages, and shops.

Purpose
The asset management strategy plays a significant role in our HRA Business Plan, and needs to take account of three key themes that we propose form the purpose of the strategy:

- ***Stock Investment-*** Investing to maintain the stock to a standard that meet customer and business need and regulatory requirements.

- ***Active Asset Management-*** Activities to improve the performance of assets that have a poor social, economic or environmental performance, because of low demand or high costs, and either improving them or replacing them with properties which are fit for purpose.

- ***Supporting wider objectives -*** Being clear where and how asset management is supporting wider objectives, such as building safety, energy efficiency and meeting housing need in line with our strategic aims.

3. Context

The environment in which the Council operates reflects continued public sector spending constraints and welfare reform, leading to a reduction in social rents. The Government has now agreed a 5-year settlement where registered providers of social housing can increase rents by up to CPI + 1% per annum.

Government is currently legislating for changes to the management of building safety. This is likely to introduce additional costs and management obligations on landlords of buildings over 18m or 6 storeys, as well as having an impact on lower rise buildings. Whilst the Council has no buildings over this threshold, an impact in the approach to management of the wider stock is to be expected. Landlord compliance activity is critical to ensuring our homes are safe. Like many providers, the Council has strengthened delivery in key areas.

Other additional cost factors to be considered are those arising from national commitments to achieve net zero carbon emissions by 2050.

The Social Housing White Paper sets out a focus for all social housing residents to be safe in their home and have a good quality home and neighbourhood to live in. The White Paper confirms the review of the Decent Homes Standard during 2021. We believe that this will lead to an updated Decent Homes Standard.

The Regulator of Social Housing (RSH) Home Standard sets out the requirements for Registered Providers as follows:

Quality of accommodation
Registered providers shall:
(a) ensure that tenants' homes meet the standard set out in section five of the Government's Decent Homes Guidance and continue to maintain their homes to at least this standard
(b) meet the standards of design and quality that applied when the home was built, and were required as a condition of publicly funded financial assistance if these standards are higher than the Decent Homes Standard
(c) in agreeing a local offer, ensure that it is set at a level not less than these standards and have regard to section six of the Government's Decent Homes Guidance.

Repairs and maintenance
Registered providers shall:
(a) provide a cost-effective repairs and maintenance service to homes and communal areas that responds to the needs of, and offers choices to, tenants, and has the objective of completing repairs and improvements right first time
(b) meet all applicable statutory requirements that provide for the health and safety of the occupants in their homes.

Whilst the Home Standard applies to the Council, Councils are not yet subject to proactive engagement with the RSH. This will change following the Social Housing White Paper and the Council can expect to be routinely checked against the regulator's standards. Whilst this should not be a change - as the Council has always aimed to meet the Home Standard anyway - it is important to use this opportunity of the review of the AMS to understand the current focus of the RSH and test our approach accordingly.

The Regulator of Social Housing (RSH) current regulatory focus continues to be on governance and viability. The Regulator has made clear that it is essential that there is a golden thread of information that links our decision making in this area to our HRA Business Plan to demonstrate viability and the suitability of our investment plans. The most recent sector risk profile highlights the most significant risks that Providers must manage and mitigate including:

- Landlord compliance – all providers have an obligation to act to ensure the homes they provide are safe and data remains a key risk.
- Stock condition – investment should be based on a good, evidenced understanding of the overall condition of stock underpinned by up-to-date data.
- Market sales exposure – the implications of the market cycle and a slowdown in some geographical areas.
- Reputational risk – decisions should have regard to the expectations of all stakeholders.
- Rents – strategies and business plans need to cope with changes in housing policy and related areas including welfare reform.
- Best value principles are also important in the context of this strategy and it is important to note the wider duties incumbent on the Council. Specifically in relation to Asset Management, it should be noted that value for money is significantly wider than the procurement of goods and services linked to the investment programme, and encompasses decision making on the investment in the asset in the first place.
- The HCAs Value for Money Standard is useful in this regard. It requires that registered providers shall deliver value for money through their repairs and maintenance programmes, and also that they *"understand the return on assets and have a strategy for optimising the future returns on assets – including rigorous appraisal of all potential options for improving value for money including the potential benefits in alternative delivery models - measured against the organisation's purpose and objectives".*

4. Asset management objectives

Linked to our Corporate Strategy (2022-24) themes set out in the box below we propose seven key objectives for asset management will underpin the new strategy:

Corporate Strategy (2022-24) Themes
Theme 1 - Caring for the environment - We have already reduced our carbon footprint and we have pledged to become a carbon neutral organisation by 2030 to help tackle climate change.
Theme 2 - Healthy Communities - We are passionate about improving housing in the social… sector. We will continue to invest in our council homes… to ensure high-quality homes are available to residents.

1. Maintain up to date and reliable information on the stock, its environmental impact, and its condition to demonstrate a comprehensive understanding of liabilities.
2. Maintain clear standards to ensure quality and safe homes and consult with tenants and other stakeholders on these standards.
3. Ensure that our investment to meet these standards is needs based and prioritised, with priorities for investment focused on areas of greatest risk.
4. Ensure that our plans are affordable within the HRA Business Plan and are considered against existing and potential objectives relating to the improvement of sheltered accommodation, acquisitions, new supply, decarbonisation, and regeneration.
5. Understand the financial and non-financial performance of our assets and deliver investment where it will generate appropriate return.
6. Carry out options appraisals on stock that does not meet our requirements or offers other opportunities, exploring a range of alternative options to improve outcomes for tenants and the HRA Business Plan.
7. Deliver value for money through clear, compliant, efficient and well monitored programmes of work.

5. Tools required to develop the strategy and deliver on the objectives

The strategy will rely on information in the following areas which will need to be regularly updated to ensure it is fit for purpose. Some of the elements outlined below require action prior to the approval of the strategy - these are highlighted as phase one tasks but will also need to be updated and refreshed. Others will be developed and maintained during its life - these are recorded as phase two tasks and the strategy will set targets for the delivery of these.

Information on the stock and its condition

To be fully compliant and understand our assets we have to maintain up to date and controlled records covering our stock and its condition. Our existing plans are based on old stock condition data based on a 50% sample originally collected in 2012. This data no longer fully meets the Council's needs in terms of informing the Asset Management Strategy or the HRA Business Plan. Whilst the data has been updated for investment works delivered since then, there are concerns that there have been periods when data update has not been comprehensive.

In addition, our current approach is to record expected component lifecycles within the database (linked to the Charnwood Standard) rather than a surveyor's opinion on when they will reach the end of their useful life. The result is that the database does not effectively capture when replacement will be required based on condition. Even if it did, in some instances, the data is now old enough that it is unlikely to provide an accurate picture of this condition.

The schedule of rates – the rates for the replacement of key components that underpin the financial forecasts from the data – also requires updating. Whilst there is a manual adjustment of this to capture more reflective rates in the HRA Business Plan (see Business Planning section below), the database needs be properly adjusted to reflect the latest outturn costs. Our current data also suggests some backlog in investment. We believe this to be driven primarily by a combination of tenant refusals and failure to update the data but acknowledge that this is based on local knowledge and should be reflected in the data.

The Council will therefore undertake a representative sample survey of the stock. This will serve to validate the existing HRA Business Plan and the existing Decent Homes Position (including identifying potential HHSRS issues). A Stock Condition Surveyor post has been recruited to, but a single post-holder will not be able to deliver the initial representative sample in a suitable timeframe.

An ongoing programme of stock surveys to support the strategy objectives and ultimately move to a position of 100% survey coverage will then be developed to support investment planning (see below). This programme, subject to evaluation and risk assessment once the results of the sample survey are known, will be delivered by the new internal resource. We will also develop and maintain an enhanced process for capturing and updating data from planned and responsive programmes and an up-to-date schedule of rates providing accurate costs of replacement. As part of this work, we will consider the use of the current IT system, and our requirements in respect of the real time update of asset data following field survey.

Phase 1 tasks

- Undertake a representative 20% sample stock condition survey.
- Check key replacement costs driving the plan against recent outturn cost.
- Cross check against internal data and HRA Business Plan and highlight any risks.
- Define strategy for remaining surveys to achieve 100% coverage.

Phase 2 tasks

- Develop procedures relating to data and maintenance to ensure that information remains up to date.

<u>Non-stock condition survey driven requirements</u>

The stock condition data should cover the replacement of key components within the property when they reach the end of their useful life. We also need to consider and define other investment requirements. This is likely to include further consideration of:

- Repairs and maintenance – including responsive and voids;
- Landlord compliance- comprehensive plans to deliver landlord compliance activity in accordance with our Policies;
- Fire Risk/Building Safety- e.g. sprinklers, doors, compartmentation, alarms, external wall systems;
- Energy- EPC C by 2030 and net zero carbon;
- Decent Homes '2' and / or any requirements emerging from the consultation on the Decent Homes Standard
- Sheltered housing improvements- the remodelling and improvement that are currently being considered to the Sheltered Housing stock;
- Complex mechanical and electrical (M&E) installations;
- Other improvements- investment which raises the standard of the stock including those areas beyond the dwelling i.e. common parts and neighbourhoods;
- Other exceptional costs.

Some of these areas are well understood and others are less certain at this stage. A detailed breakdown of current assumptions for the above areas will be compiled. Any additional investigations required will form part of the action plan associated with the conversion of this framework into the new strategy.

Some current gaps have already been identified as priority areas. These include:

- Energy- The council does hold RDSAP data, however it requires updating. The recommendation is to use the representative sample stock condition survey to collect representative energy data to inform an energy study and understand the costs of achieving SAP C and net zero carbon.

- M&E - the costs relating to communal electrical installations, common heating systems and lifts.
- Sheltered Housing improvements- more detailed costs and profile around the proposed remodelling. The HRA BP does include some allowances, but the latest cost forecasts exceed these and update is required subject to the agreement of our plans.
- Fire - the Council does not currently have stock over 6 storey or 18m. It has already done work to risk assess its fire doors and the HRA Business Plan has been adjusted to reflect the need for priority fire door replacement in the early part of the HRA Business Plan. The amount for other fire safety works has been increased from £100,000 to £300,000 in 2020 to reflect the need to address actions arising from Fire Risk Assessments and associated intrusive surveys. This allowance will need to be kept under review as further FRAs and surveys are undertaken.

Phase one tasks

- Review existing cost forecasts from currently available information for the key areas outlined above.
- Highlight areas where we do not currently have sufficient information to assess and plan further investigations where required.
- Capture new RDSAP data as part of the representative sample survey and undertake a high level energy study to forecast the likely costs of achieving SAP C and net zero carbon.
- Develop updated cost forecasts and profile for the planned Sheltered Housing improvements.
- Undertake M&E surveys in blocks with complex M&E and sample other blocks to test current assumptions.
- Maintain a costed list of actions arising from FRAs and associated surveys and cross check with fire safety related HRA Business Plan allowances.

<u>Investment Priorities and Standards</u>

There are a number of possible scenarios around asset investment. Whilst some investment is essential and non-discretionary (e.g. statutory compliance activity or work to maintain Decent Homes), other investment is more discretionary. Of our more discretionary investment, some will be key to maintaining the income stream (e.g. the re-modelling of hard to let Sheltered accommodation) whilst other may be more based on improving tenant satisfaction (e.g. environmental improvements on estates). Investment priorities are not currently documented, although the HRA business planning process does include some prioritisation and annual programmes of investment are prioritised.

As a result of the limitations in the age and coverage of the existing data, it is not possible to identify prioritised investment from the current data. Local knowledge and manual intervention is needed to develop programmes of work. Enhancements to

the data will enable us to provide Members and tenants with greater assurance that the highest priority requirements are being met and that there is sufficient capacity for any improvement related spend.

The Charnwood Standard is currently in place. This focuses primarily on the replacement of key components - such as kitchens and bathrooms - when they reach the end of their allocated lifecycle as opposed to when their condition dictates that they require replacement. The result of this is that the components should be more modern - the Charnwood Standard goes beyond the modernity standard in Decent Homes - but, in setting a maximum age for these components, the Council risks replacing components still in reasonable condition. In addition, the average lifecycle will likely drop below the expected lifecycle as some components will be replaced early owing to their condition but these cannot be offset by other components being replaced later where condition allows. The review of the strategy allows us to consider if the Charnwood Standard remains appropriate in the context of the wider investment priorities.

Phase one task

- Document existing investment priorities and review the Charnwood Standard with stakeholders in the context of the survey results.

<u>Asset Performance Evaluation</u>

Typically, the Council has focused on when and not if investment should be made in the housing stock. Whilst the vast majority of the HRA stock will remain for the 30-year life of the HRA Business Plan, we need to do more work to develop our understanding of how our assets perform in order that we can appraise investment options.

As part of the development of this strategy we will carry out an exercise to assess the performance of all our housing stock. This groups the stock according to archetype and locality and considers the following:

- Rental income and void rent loss;
- Repairs and maintenance expenditure;
- Future 30 year planned maintenance expenditure (including stock condition and non-stock condition driven cost);
- Housing management costs.

It will be essential to evaluate performance across a range of factors, not just financial, reflecting the social objectives of the Council. This social analysis is essential and can enable these factors to be objectively assessed and demonstrated in order to provide the information needed to make investment decisions going forwards. We will develop these non-financial measures as part of our asset performance evaluation.

A scoring system will be developed and we will use the following matrix to prioritise investigations:

<table>
<tr><td colspan="2"></td><td colspan="4">Financial Sustainability (NPV)</td></tr>
<tr><td colspan="2"></td><td>Green (TBC)</td><td>Amber (TBC) and increasing</td><td>Amber (TBC) and decreasing</td><td>Red (Negative)</td></tr>
<tr><td rowspan="3">Non-financial Sustainability</td><td>Score TBC</td><td colspan="2" rowspan="2"></td><td rowspan="3">Priority 2</td><td rowspan="3">Priority 1</td></tr>
<tr><td>Score TBC</td></tr>
<tr><td>Score TBC</td><td colspan="2">Priority 3</td></tr>
</table>

Where stock is performing poorly, on either a financial and/or social return basis (i.e. priority groups 1-3 above), a more detailed evaluation of the drivers of poor performance will be undertaken before investment decisions are made (excluding essential investment for H&S which should be made regardless to ensure tenant safety and Decency). This will avoid investment in unsustainable stock. Where appropriate, alternative options will be explored. Appraisal options will consider:

- Demolition and redevelopment;
- Limited life- medium term investment plan or short term responsive and cyclical repairs;
- Disposal of some or all units on the open market;
- Change of use or unit type- either short term of long term.

It is important to note that in some cases none of the above will be appropriate. The target of the strategy will be informed decision making - even if that decision is the status quo - as opposed to mandating alternative strategies in the event of poor financial or social performance.

Phase one task

Plan an asset performance exercise.

Phase two task

Complete asset performance evaluation and present results. Provide initial information to enable a strategic discussion and plans for further investigations and appraisal. Subsequently incorporate results in to AMS for approval.

<u>Housing market and demand</u>

The updated Asset Management Strategy will be aligned with a Housing Strategy which will provide an understanding of the local housing market

Growth/mitigating stock reduction from RTB

The Council has utilised one for one Right to Buy capital receipts to fund 30% of acquisition costs of properties to meet the need for affordable rented homes with the remaining 70% from the Housing Revenue Account. As of 31st March 2021, the Council has purchased 38 properties either for sale on the open market or offered back to the Council through the Right of First Refusal scheme.

In addition, the Council has taken opportunities to acquire properties via S106 Agreements resulting in 5 additional units in Shepshed and 27 in Queniborough.

However, the impact of the Right to Buy legislation continues to see an annual net loss in the Council's housing stock which reduces the number of affordable properties available to those households on low income and impacts on the viability of the HRA Business Plan.

Phase two task

Once phase one tasks are complete, develop a growth strategy to mitigate the impact of the Right to Buy and maintain affordable housing supply within the constraints of the HRA Business Plan.

Business Planning

The current HRA Business Plan includes allowances to fund existing commitments, but the age and coverage of the existing data means that it relies on a series of manual adjustments and the application of local knowledge. Whilst there is visibility of the assumptions made and these are recorded amongst supporting information, there needs to a golden thread from recently collected information through to the plan.

The result is that the profile of work indicated by the stock condition varies from that in the HRA Business Plan in some areas. The HRA Business Plan has been manually adjusted for the fact that the existing data is incomplete as it does not contain survey data on every component/property. When this is combined with the backlog expenditure indicated by the raw data, it increases the risk of the HRA Business Plan expenditure profile being incorrect.

The HRA Business plan has been updated to reflect the emerging liabilities around fire safety and to include some, but not all, of the improvement expenditure for the sheltered housing project.

It is for the reasons outlined above that the recommendation of a new stock condition survey and associated 30-year cost forecast is made. This will allow the Council to validate the assumptions being made in the HRA business planning process and provide stakeholders with assurance around the suitably of these.

This will enable this new strategy to emerge alongside a validated 30-year cost plan covering the stock condition and non-stock condition items considered above. Alongside this, the agreed investment priorities and standards will be developed. Affordability testing will be key and there must be a golden thread between the plan and the underlying data.

Phase one task

Ensure the initial strategy and discussion is based on the affordability limits within the previously agreed plan or present business case to revise the existing plan as required.

Phase two task

The associated Investment Plan will be approved annually to confirm alignment to the business plan and affordability. This is particularly relevant to understanding the impact of increases in the costs of delivery rate (either through inability to achieve target costs or cost inflation) or an increase in requirements (e.g. net zero carbon or Decent Homes 2) which will be stress tested.

<u>Short term investment plan</u>

The Council currently plans investment on an annual basis. The objective is to develop a longer-term programme of work that can provide stakeholders with greater visibility of work in the medium term. The investment planning process envisaged by the new strategy is designed to create a 5-year programme of work to determine:

- What works are required
- To which properties
- In which works package
- In which year
- Budget ensuring that the investment plan fits within the financial parameters of the business plan.

The investment plan is important to support effective procurement and value for delivery, and to provide resident visibility. The strategy will commit to the development of a five-year investment plan on this basis.

Phase two task

- Produce the 5 Year Investment Plan

<u>Skills and expertise</u>

Once the investment requirements are fully understood, a review of the Asset Management Team structure will be undertaken and the action plan accompanying the framework will highlight any changes required to deliver against requirements.

Risk management

The strategy will need recognise that housing assets can also become liabilities, creating a risk to viability as well as significantly impacting on residents' lives. Key risks to cover in the strategy will include:

- Failures to manage health and safety compliance could put residents, staff and contractors at risk.
- Failures to meet statutory or regulatory standards can carry penalties and will damage the organisation's reputation.
- Failure to maintain the golden thread between the understanding of stock condition and investment need and the allowances within the Business Plan.
- An incorrect scope or poor quality of stock investment will have a key influence on customer satisfaction.
- Poor value for money in stock investment will have a major impact on our finances as this represents a very large proportion of our HRA spend.
- Internal and external factors impact on investment need and expenditure. Key amongst these are currently fire/Building Safety and energy efficiency. We will need to remain aware of the impact of these on investment levels in existing stock and any subsequent impact on our investment plans.
- Internally published standards will need to be reviewed - changing standards may carry reputational risk.

A process to identify and assess risks is in place and actions agreed to manage risks to minimise impact. All key asset management related risks including financial, operational, delivery risks (e.g., failure to invest) are captured in the appropriate operational risk register.

Action and Next Steps

Action required and next steps are as follows:

- Accept the approach and timetable to strategy development;
- Agree the Asset Management Objectives;
- Note the phase one requirements and associated limitations;
- Note the risks and ensure that these are adequately captured in risk registers.

Appendix 1 - Summary of Tasks

<u>Phase 1</u>

1. Enhance Data

- Undertake a representative 20% sample stock condition survey alongside an asset performance exercise.
- Capture new RDSAP data as part of the representative sample survey and undertake a high-level energy study to forecast the likely costs of achieving SAP C and net zero carbon.
- Undertake M&E surveys in blocks with complex M&E and sample other blocks to test current assumptions.
- Maintain a costed list of actions arising from FRAs and associated surveys and cross check with fire safety related HRA Business Plan allowances.

Analyse Data against existing proprieties and consult stakeholders on investment properties

- Check key replacement costs driving the plan against recent outturn cost.
- Review existing cost forecasts from currently available information for the key areas outlined above.
- Highlight areas where we do not currently have sufficient information to assess and plan further investigations where required.
- Develop updated cost forecasts and profile for the planned Sheltered Housing improvements.
- Document existing investment priorities and review the Charnwood Standard with stakeholders in the context of the survey results.
- Cross check against internal data and HRA Business Plan and highlight any risks.

Produce and Output Strategy

- A process to identify and assess risks is in place and actions agreed to manage risks in order to minimise impact. All key asset management related risks including financial, operational, delivery risks (e.g. failure to invest) are captured in the appropriate operational risk register.
  Ensure the initial strategy and discussion is based on the affordability limits within the previously agreed plan or present business case to revise the existing plan as required.
- Define strategy for remaining surveys to achieve 100% coverage.
  Updated draft strategy in Quarter 2 of 2022/23

Phase 2

Develop Systems and Maintain Data Quality

- Develop procedures relating to data and maintenance to ensure that information remains up to date.
- Consider the use of the current IT system, and our requirements in respect of the real time update of asset data following field survey.

Asset Performance and Growth

- Using data from asset performance evaluation - present results. Provide initial information to enable a strategic discussion and plans for further investigations and appraisal. Subsequently incorporate results in to AMS for approval.
- Develop a growth strategy to mitigate the impact of the Right to Buy and maintain affordable housing supply within the constraints of the HRA Business Plan.

Develop Investment Plan

- Produce the 5 Year Investment Plan.
- The associated Investment Plan will be approved annually to confirm alignment to the business plan and affordability. This is particularly relevant to understanding the impact of increases in the costs of delivery rate (either through inability to achieve target costs or cost inflation) or an increase in requirements (e.g. net zero carbon or Decent Homes 2) which will be stress tested.

- Put resources in place.
- Once the investment requirements are fully understood, a review of the Asset Management Team structure will be undertaken and the action plan accompanying the framework will highlight any changes required to deliver against requirements.

Housing Revenue Account Business Plan & Capacity Review

Draft Report
November 2021

savills

Contents

1. Introduction

1.1. Background

Charnwood Borough Council (CBC, the Council) have commissioned Savills to produce an updated HRA Business Plan and review of the Asset Management Strategy which were both last produced in 2014.

The report focuses on the production and outputs of the HRA business plan but does refer to the outcome of the separate review of the Asset Management Strategy. It takes a holistic view on the current HRA budget and compares current cost levels with benchmarks for similar sized local authorities.

In updating the HRA business plan we have also considered the impact in light of the abolition of the HRA debt cap, and the potential for the introduction of greater flexibilities around the reinvestment of Right to Buy receipts. Like many authorities, the Council has adopted a new approach to setting out the financial capacity and capability of the HRA to deliver on its objectives towards refurbishment, investment, regeneration and new supply. This new approach is also consistent with the requirement for the publication of Prudential Indicators specific to the HRA following their reintroduction alongside the abolition of the debt cap.

Savills have therefore updated the 2014 HRA business plan, in conjunction with officers, offering our thoughts on the methodology, approach and assumptions, with a focus on setting a series of target prudential indicators / metrics which may then inform the basis of the long-term financial management and investment strategy delivered within the business plan.

1.2. Approach

In order to carry out this commission we were provided the following:

- A full breakdown of the 2021.22 HRA Budget
- The 30-year projections for investment in the stock
- The full rent schedule for existing properties
- Potential investment opportunities

We have also drawn on our extensive financial database to provide appropriate benchmarks for both a high-level and in-depth comparison.

To produce the HRA business plan we have used our latest platform to model the 30-year projections and to provide a view on both viability but also borrowing capacity to allow for future and additional investment.

2. HRA Budget Review

2.1. HRA Budget

The HRA business plan is launched from the latest approved budget which is detailed below:

Table 2.1: HRA Budget

	2021.22 Budget
Income:	
Dwelling Rents	£21,100,000
Non-Dwelling Rents	£355,000
Charges for Services & Facilities	£441,000
Warden Charges	£49,000
Central Heating	£67,000
Other Income	£95,000
Interest & Investment Income	£25,000
Total Income	**£22,132,000**
Expenditure:	
Repairs & Maintenance	£6,802,000
Supervision & Management	£5,666,000
Contribution to Bad Debt Provision	£383,000
Depreciation (transfer to MRR)	£3,409,000
Debt Management Costs	£10,000
Interest Payable	£2,709,000
Total Expenditure	**£18,979,000**
Surplus	**£3,153,000**
Contribution from Reserve	£365,000
Revenue Contribution to Capital	(£3,523,000)
Net Surplus / (Deficit)	**(£5,000)**

The HRA shows a forecast deficit of £5,000 which occurs after the revenue contribution to capital. CBC also holds an HRA Financing Reserve of £5.623million which is after the £0.365million contribution to the general HRA reserve. This is therefore in addition to the £0.602million forecast balances within the HRA general reserve.

The HRA business model has been balanced to the above budget in order to project future cashflow income and expenditure prior to the financing of capital expenditure.

Table 2.2: HRA Capital Budget

	2021.22 Budget
Expenditure:	
Investment in Stock	£6,331,500
Acquisitions	£1,050,000
Total Income	**£7,381,500**
Financed By:	
Major Repairs Reserve	£3,408,700
'1-4-1' Receipts	£450,000
Revenue Contributions	£3,522,800
Total Expenditure	**£7,381,500**

The Major Repairs Reserve, to which the depreciation charged to the HRA is credited, is forecast to hold balances of £3.111million in March 2012.

A small programme for 6 open market acquisitions is budgeted this year, which is part-subsided by the use of '1-4-1' retained right to buy receipts.

2.2. Benchmarking

In order to compare Charnwood's cost basis we have utilised our national database of the accounts for stock holding local authorities and identified a peer group of 15 local authorities with a range of 3,600 to 5,700 properties located in the Midlands and East of England. The results are shown on a per unit basis to allow for direct comparison.

The costs for financial year 2020.21 will be impacted due to the Coronavirus pandemic in that expenditure, particularly for repairs, would be lower than previous years, hence we have shown the values for 2019.20 as well.

For further comparison we have shown the per unit values for the 2021.22 budget as well.

Table 2.3: Benchmarking Analysis (per unit)

	2019.20 Actual		2020.21 Actual		2021.22
	Charnwood	Peer Group	Charnwood	Peer Group	Charnwood
All Management (per unit)	£1,056	£1,258	£1,100	£1,257	£1,027
Net Management (per unit)	£813	£889	£880	£896	£845
Repairs (per unit)	£1,086	£1,030	£1,003	£1,053	£1,234
Depreciation (per unit)	£586	£914	£625	£972	£618
Operating Surplus (per unit)	£1,056	£1,256	£1,054	£1,284	£1,057
Rents	£71.73	£81.70	£74.73	£83.14	£75.26

The all management costs incorporate the total running costs for the service exclusive of the provision for bad debts, depreciation and interest charges, whereas the net management cost offsets the income from non-dwelling rents, service charges and other income, excluding interest earnt.

The analysis shows that both gross and net management costs are lower than the peer groups for the two years of accounts with 2021.22 likely to follow suit.

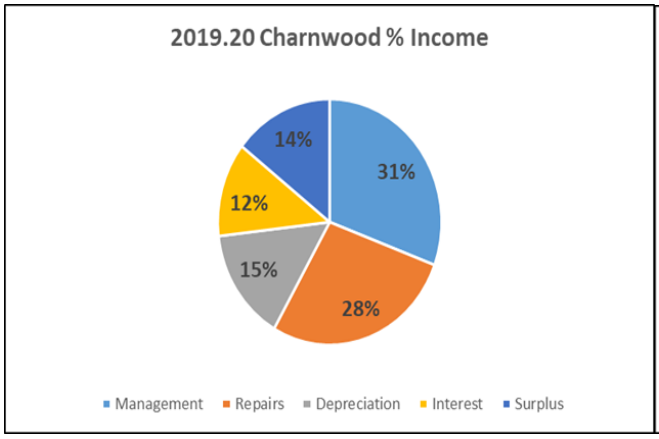
Repairs expenditure is relatively in-line with the peer group, although 2021.22 shows an increase in expenditure, to which we review further in the following section.

The depreciation charge is lower than the peer group by some margin. Whilst this is not material as surpluses generated by the HRA, which would be increased by a lower depreciation charge, are offset by higher revenue contributions to capital to fund the programme. It is however, a key component when considering borrowing capacity further in this report.

The operating surplus (prior to interest) remains relatively stable across all three years, but is lower than the peer group. A major factor in accounting for the difference is the level of rent charged, but also the lower depreciation charge.

In order to make further comparisons we have shown graphically the difference in the key HRA expenditure headings expressed as a percentage of the total income (which includes rents less voids, non-dwelling rents and charges, service charges and other forms of income).

Chart 2.4: 2019.20 Benchmarking Analysis (percentage expenditure)



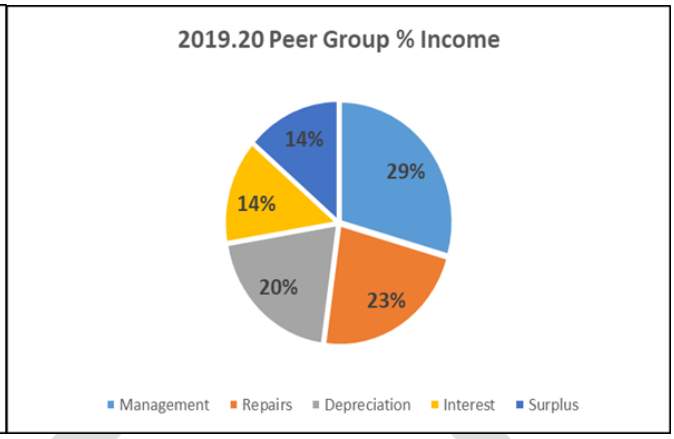
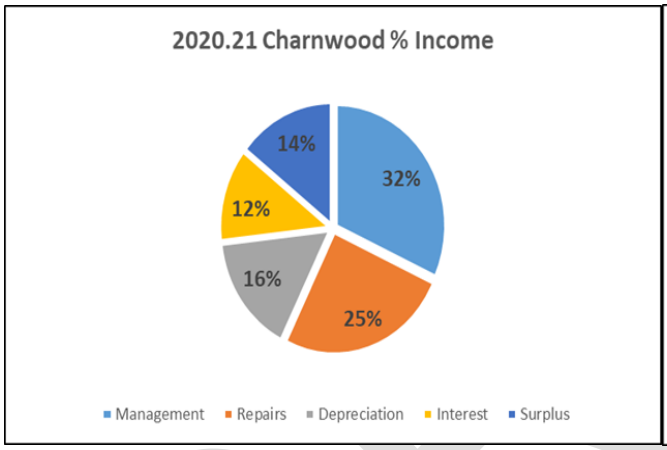


Chart 2.5: 2020.21 Benchmarking Analysis (percentage expenditure)



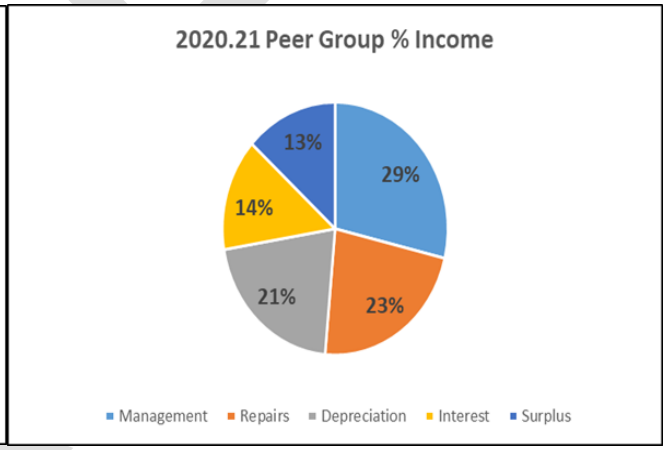
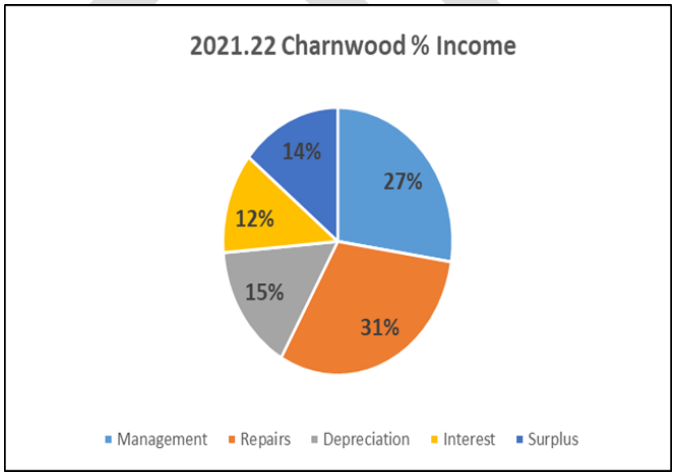


Chart 2.6: 2021.22 Benchmarking Analysis (percentage expenditure)



In terms of the two years direct comparison with the peer group and 2021.22 budget there are no significant outliers other than the following:

- Repairs expenditure for 2019.20 and 2021.22 demonstrates a higher level of expenditure, which is reflected in the above table.
- Depreciation also differs again due to the lower provision made by CBC
- Interest charges are lower on account of the smaller debt level in comparison to the peer group

Interestingly though, the resulting surpluses appear to be in line, which results in no draw upon reserves.

2.3. In-Depth Review

As per our commission we undertook a desktop holistic review of the key budgets within the HRA. In doing so we were provided with a comprehensive list of all of the HRA budgets by both cost centre but also account code. This allowed us to categorise expenditure in order to compare with our knowledge and database of other HRAs.

Our summary of the accounts is as follows:

Non-Rental Income

The budgets primarily cover:

- Rent from Land
- Garage Rents (less 31% void allowance)
- Shop Rents (less 24% void allowance)
- Service Charges (less various levels of void allowance c34%)
- Council Tax Recharged
- Ground Maintenance Contributions

These are set locally and therefore cannot be benchmarked as they based on the profile of assets specific to CBC. The void rates, however, have a significant impact to the coverage of actual costs for services.

Management

We have reviewed the detailed budgets that make up the £5.441million costs for management.

We have categorised the expenditure for the costs by reviewing the account codes for the following headings:

- Direct Salaries: £3,168,200
- Direct Costs: £1,681200 (net of income)

- Overhead Costs: £1,651,400
- Recharges: (£1,023,500)

The proportion of salary costs is equivalent to 49% of expenditure, whilst net direct costs account for 26% leaving 25% for central overhead recharges.

The level of recharges appear to be at the higher end than other authorities to which we hold data as a percentage of overall management expenditure with ranges between 12% and 27%.

Another analysis is the split between core and non-core management activities. Our analysis shows that 19% of expenditure is deemed non-core, which is deemed supplementary to the specific landlord function. This compares to benchmarks of between 15% and 21% elsewhere.

Repairs

As with management budgets with have reviewed the cost centre and accounts that are associated with the repairs service.

We have categorised the expenditure for the costs by reviewing the account codes for the following headings:

- Direct Salaries: £2,847,712
- Direct Costs: £3,264,729
    - Of which: £635,000 on subcontractors
- Overhead Costs: £689,859

The salaries proportion is 42% which is at the lower end of benchmarks with other local authorities that have a direct workforce rather than a repairs contractor.

Overheads from the General Fund charged to repairs account for 10% of the overall budget which again is line with benchmarks with local authorities with a typical range of 8% to 16%.

The direct costs are formed from a variety of expenditure including materials, sub-contractors, transport and internal operational related costs. The level of sub-contractor accounts for 9% which is very much at the lower-end of what we have seen with other Councils. This is a positive, given less reliance upon external services.

Financing Costs

There will be a variety of reasons for the cost of borrowing charged to the HRA. This will be due to loans attributed to the HRA, when they were financed and duration. Currently, the average interest rate for CBC is 3.43%. This compares favourably with the national average rate of 4.01% whilst the peer group used for the benchmarks above is 3.06%.

Given the majority of borrowing would have been to finance the self-financing settlement the rates are within the expected range, given the duration of some of the loan facilities.

Capital Fees

From the accounts analysis £299,700 is charged to capital expenditure for the management of the capital programme. Due to the fluctuation of capital expenditure the fees equate to between 4% and 7% which is well within the expected 8% benchmarks.

3. Capital Investment & Financing

3.1. 30-Year projections

The following table shows the latest projections for the stock investment required for the stock summarised in 5-year segments. Year 1 in the table represents financial year 2020.21, and as we have launched the model from 2021.22 and used the actual capital programme we have drawn from the figures commencing in year 3 with allowances for inflation. Therefore, we have had to assume an average level of expenditure for the plan in the final 2 years.

Table 3.1: 30-Year Stock Investment Requirements

Component	Yrs 1-5	Yrs 6-10	Yrs 11-15	Yrs 16-20	Yrs 21-25	Yrs 26-30	TOTAL
Bathrooms	5,369,532	2,159,425	3,682,901	2,143,959	6,744,495	4,479,596	**24,579,909**
Kitchens	2,354,912	3,692,371	8,393,990	6,654,473	2,683,123	2,916,973	**26,695,841**
Heating	2,354,681	6,921,857	1,650,028	2,609,547	11,211,874	2,540,702	**27,288,690**
Wiring	1,582,256	2,526,553	2,526,553	2,526,553	2,526,553	2,526,553	**14,215,022**
Windows	419,628	2,391,879	6,174,126	5,684,560	607,062	2,798	**15,280,053**
Doors	3,459,170	150,250	492,140	542,200	1,704,600	1,641,520	**7,989,880**
Roof/Insulation	2,105,600	1,222,800	16,000	1,750,300	2,240,000	2,181,600	**9,516,300**
Structural	1,250,000	1,250,000	1,250,000	1,250,000	1,250,000	1,250,000	**7,500,000**
Asbestos	530,000	200,000	200,000	200,000	200,000	200,000	**1,530,000**
Fire Safety	700,000	50,000	50,000	50,000	50,000	50,000	**950,000**
Smoke Detectors	449,325	0	0	449,325	0	0	**898,650**
Adaptations	2,800,000	2,800,000	2,800,000	2,800,000	2,800,000	2,800,000	**16,800,000**
Major Voids	1,340,000	1,250,000	1,250,000	1,250,000	1,250,000	1,250,000	**7,590,000**

Component	Yrs 1-5	Yrs 6-10	Yrs 11-15	Yrs 16-20	Yrs 21-25	Yrs 26-30	TOTAL
Communal Works	2,140,370	850,925	850,925	850,925	850,925	850,925	**6,394,995**
Estate Works	1,015,000	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	**6,015,000**
Other Sheltered	275,000	0	125,000	240,000	60,000	0	**700,000**
IT Replacement	0	300,000	0	300,000	0	300,000	**900,000**
Garages	470,000	0	0	0	0	0	**470,000**
TOTAL	28,615,474	26,766,060	30,461,663	30,301,842	35,178,632	23,990,667	**175,314,340**

This table demonstrates a total of £175,314,340 of capital investment for the HRA over the 30 year period. The above table excludes the provision for capitalised fees to manage the annual programme of £299,700, which has been included within the financial projections.

Within the model we have assumed that some components, for example kitchens and bathrooms, are considered variable and therefore adjusted within the projections for loss of stock through right to buy.

3.2. Review of the Asset Management Strategy Framework

Savills have been appointed, as part of our commission, to review the database used to arrive and the above costs and provide support for the preparation of the Asset Management Strategy Framework.

The key themes of the Asset Management Strategy Framework:

- ***Stock Investment-*** Investing to maintain the stock to a standard that meet customer and business need and regulatory requirements.

- ***Active Asset Management-*** Activities to improve the performance of assets that have a poor social, economic or environmental performance, because of low demand or high costs, and either improving them or replacing them with properties which are fit for purpose.

- ***Supporting wider objectives -*** Being clear where and how asset management is supporting wider objectives, such as building safety, energy efficiency and meeting housing need in line with our strategic aims.

Our observations of the current database are:

- Stock Condition data:
  - Based on 50% sample carried out 2012 which has not been regularly updated
  - Risk that condition and components reaching end of life cycle are not factored into the projections
  - The need for a sample survey to validate business plan/asset management strategy and decent homes compliance

- Other non-survey requirements:
  - Energy – RDSAP data held but appears old and not updated
  - Mechanical & Electrical – costs not up to date - specialist surveys may be required for complex equipment
  - Sheltered Housing Improvements – small provision made
  - Fire Safety – not large exposure but allowances made for additional works need reviewing – additional specialist surveys and additional FRAs

- Asset Performance Evaluation:
  - Currently the focus is on when rather than if to invest in the stock.
  - Understanding asset performance critical in future

- Investment Standards:
  - Charnwood Standard used as reference point
  - Beyond decent homes standard
  - Based on life-cycle rather than condition and need for replacement
  - Risks replacing items still in reasonable condition
  - Asset management strategy to be reviewed in context of wider investment priorities

- Business Planning:
  - Existing commitments covered but age and extent of existing data means manual adjustments required
  - Raw data shows backlog expenditure – risk of spend profile being incorrect
  - Risk of less effective investment programmes without link back to effective core data

In summary, the levels of expenditure are within expected benchmarks over the 30 years but risks some expenditure not being properly prioritised.

Therefore the draft Asset Management Strategy Framework has identified a series of tasks to tackle this through two phases.

More work and conversation however, is required for the move towards the stock becoming zero-carbon.

3.3. New Housing Supply

At present the model includes for the acquisition of 6 properties in the form of ex-Council homes for 2021.22 only. The acquisitions utilise the 1-4-1 receipts that occur from right to buy receipts.

Whilst the regulations are changing for the use of right to buy receipts the impact of this has no bearing on CBC's HRA and would actually allow for a greater percentage of 1-4-1 receipts to be used.

We have modelled a scenario of the continuation of the continuation of the acquisition programme in section 6 on this review.

3.4. Sheltered Scheme Review

Currently CBC is witnessing high void levels within in sheltered stock due to some of the properties not being fit for purpose and therefore difficult to re-let. This impacts upon loss of rental income but also service costs that are unrecoverable.

Within the above table no investment, that is included within the base plan, has been provided for sheltered scheme remodelling.

We have therefore modelled a scenario where some of the existing schemes are remodelled and then the impact to the plan can be assessed.

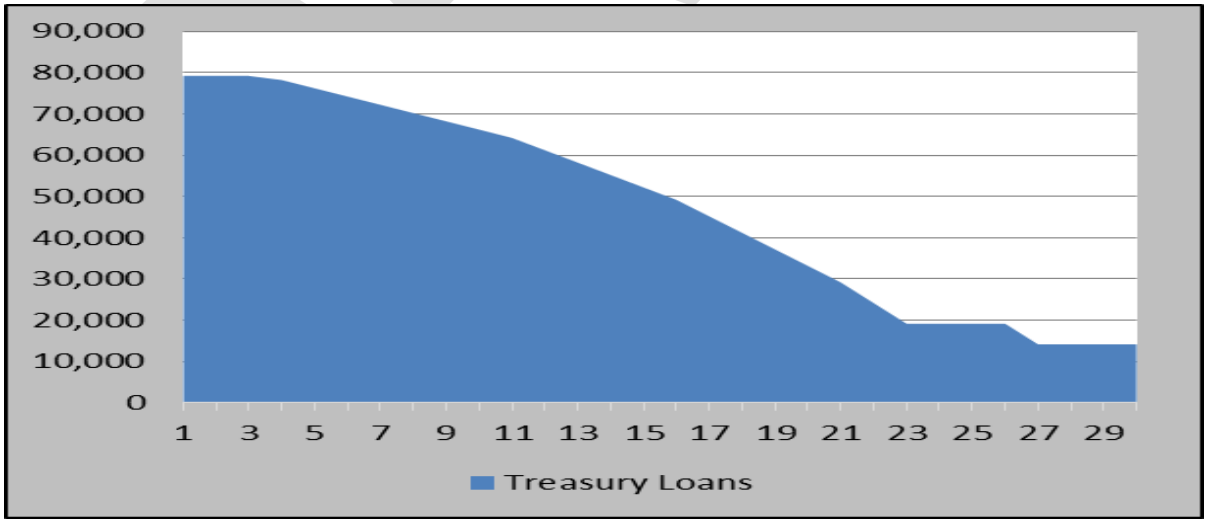
3.5. Current Financing of the HRA

The HRA level of debt is defined by its HRACFR (Capital Financing Requirement). It currently stands at £78,620,000 and is financed by:

- 24 Loans with various maturity dates totalling £79,190,000
- This results in 'over-financing' of £570,000 to which interest is received from the CBC General Fund

The loan portfolio and future balances from loan maturities is shown below:

Chart 3.1: Loan Balances – Current Portfolio



This demonstrates that the projected loan balances reduce to £14.190million over the 30 years. This excludes any refinancing of the loans or additional borrowing required.

The average interest charge for the current portfolio is 3.43%.

4. HRA Business Plan Projections

4.1. Future Assumptions

The model is launched from 2021.22 using the budgets as in table 2.1, the loans within chart 3.1 and the stock investment requirements in table 3.1.

In order to produce future cashflow projections for the HRA we have made the following assumptions:

1. Core Inflation running through the plan is set at 2% based on the Government's long-term CPI (consumer price index) target of 2%, with 2.5% applied for years 2 & 3.
2. Rents for 2022.23 will increase by 4.1% on the current levels of £75.28 and then for April 2023 and April 2024 by CPI plus 1% following the current social rent policy. Thereafter rents will increase by CPI only
3. Properties re-let to new tenants will be at formula rent which is £1.11 than the current level and a turnover rate of 2.5% is assumed on a reducing balance basis
4. Void rates rent lost are set at current reflecting the difficulties with letting some sheltered stock
5. Bad Debt Provision continues to be set at 1.77% of rental income
6. Right to Buys remain at 40 per year for the first 3 years and then reduce by 10% per year, at total of 476 properties representing 8.6% of the current stock
7. All service charges and other forms of income will increase by CPI only
8. All management related costs will increase by CPI only
9. Repair cost will increase by CPI only but adjusted by 20% (pro-rate) for stock loss
10. Capital Expenditure increases by CPI only with some components adjusted for stock loss, with an uplift of an additional 7% on the values in table 3.1 for application from 2022.23 onwards
11. Loans upon maturity will be repaid from HRA reserves or surpluses but where refinancing is required an interest rate of 3.5% is assumed for medium-term borrowing
12. The minimum balance for the HRA has been set at £0.55million and increases with inflation
13. We have assumed that the HRA Financing Reserve is utilised to finance the loan repayments overs years 4 to 7 of the plan.

4.2. Financial Outputs

The charts below summarise the forecast:

- Revenue reserves forecast over 30 years
- Capital programme forecast over 30 years
- HRA Debt forecast over 30 years.

Chart 4.1 - Revenue Reserves forecast 2021-2051 Baseline Position

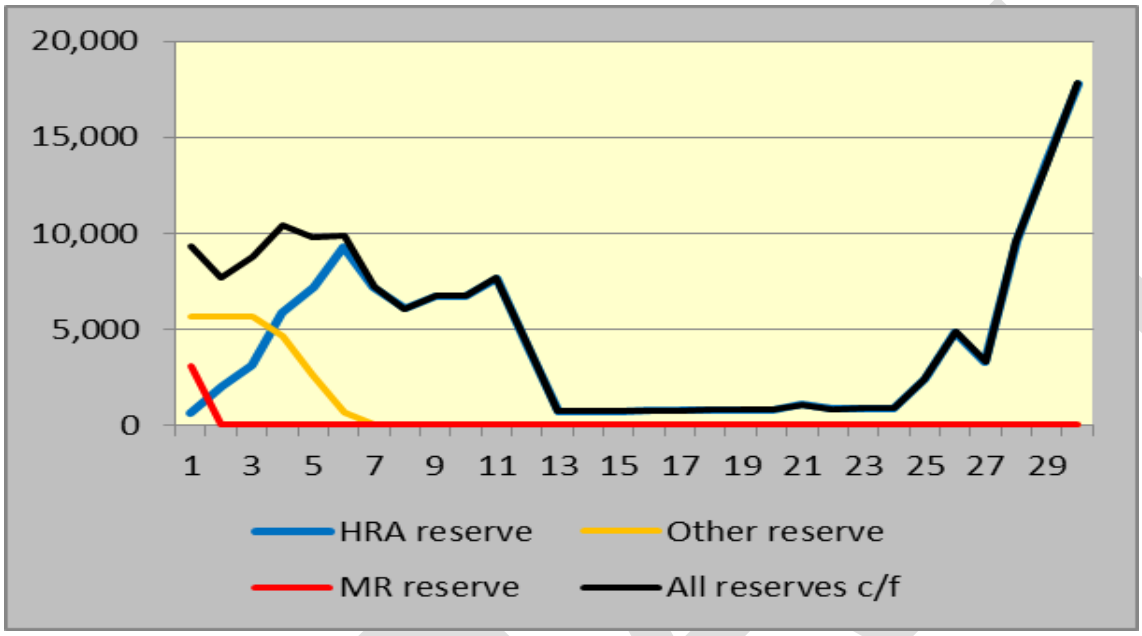


Chart 4.2 - Capital expenditure and financing forecast 2021-2051 Baseline Position

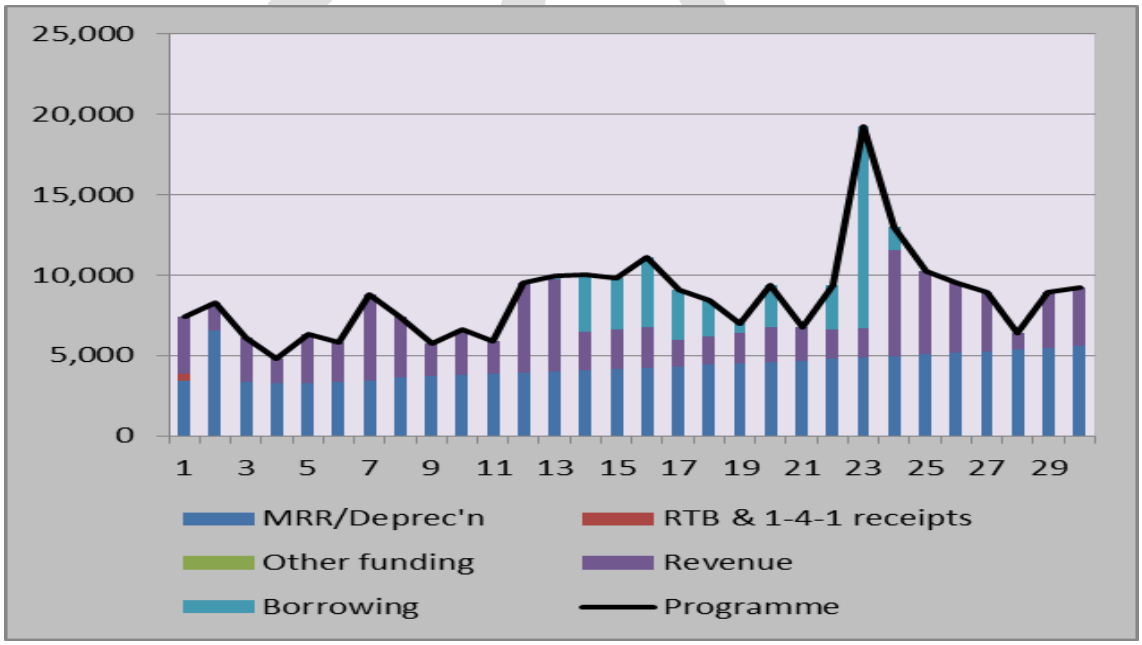
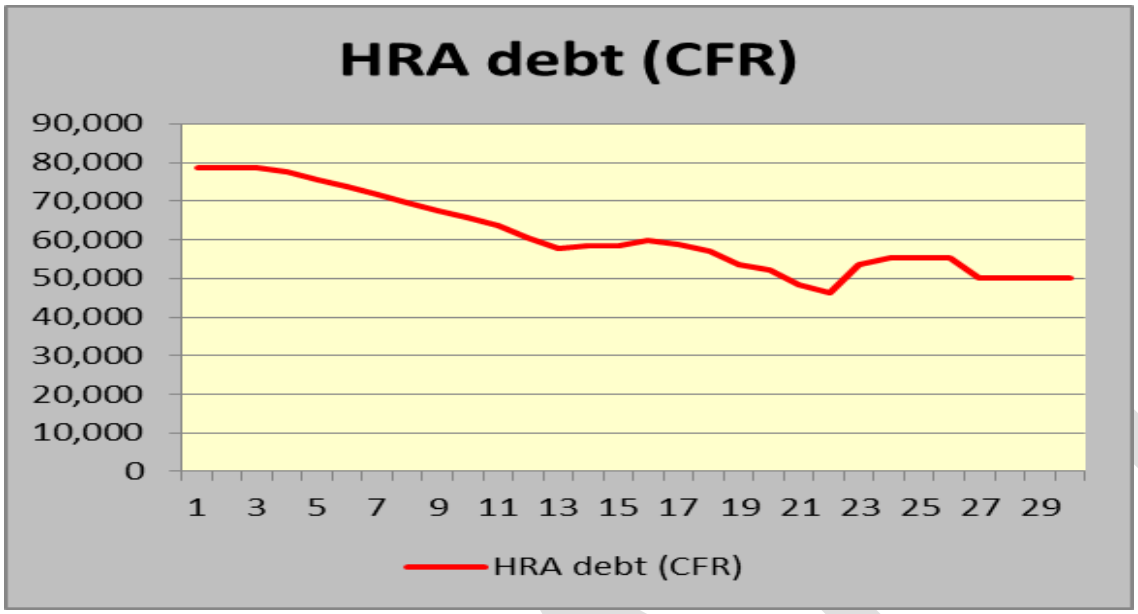


Chart 4.3 - HRA Debt forecast 2021-2051 Baseline Position



4.3. Summary

The revenue projections show that available reserves are utilised over the early stages of the plan to finance both capital expenditure and loan repayments. Due to capital expenditure increasing in year 12, in comparison to the previous years, the HRA balance falls to the pre-set minimum levels. This continues for a period of 12 years and then balances begin to accrue as capital expenditure begins to reduce compared to the mid-term levels of the plan.

The capital expenditure chart shows that the programme is fully funded in each of the years by a variety of resources, but substantially from the HRA itself but with the requirement for additional borrowing in the mid-term of the plan.

The debt levels of the HRA (HRACFR) initially reduce on account of the loans maturing during this period. However, in the mid-term of the plan whilst there are loans continually maturing there is a need to both refinance these loans but also additional borrowing required. The net effect of this is shown in chart 4.3 where in years 14 to 17 there is an overall growth in borrowing. Later into the plan, due to the high levels of forecast capital expenditure, further borrowing is required.

In overall terms the HRA revenue position remains balanced and is forecast to have reserves of c£17.8million in 30 years, whilst ensuring a fully financed capital programme. The levels of debt commence at £78.62million and are forecast to be c£50.2million in 30 years, of which £14.9million will be accounted for with existing loans.

There is no statutory requirement for the repayment of debt within the HRA. It is likely though that once a revisit of the stock investment requirements is undertaken that the profile of required borrowing may change.

5. Capacity analysis

5.1. Introduction and methodology

The HRA debt cap represented an artificial constraint on borrowing set outside the HRA and linked to future income and cost assumptions which were made in 2012. The housing and financial policy environment has moved on considerably since then, however the only change in the debt cap until 2018 that was implemented was for a small minority of authorities that opted to bid for an increase in 2014.15.

The proposition within this analysis is that, whilst there is theoretically now no limit to borrowing within the HRA, the existing asset and operating base generates a net income stream that does offer a logical limit on sustainable borrowing levels. In setting out its investment strategy, the Council therefore needs to consider how it will take decisions on whether to invest, how to fund, the extent of new borrowing, and determine a framework within which decisions will be taken for the business plan overall, within the MTFP and within successive budget rounds.

This report applies some metrics developed in the light of the experience of 40 years' of successful private finance of housing associations, during which associations have developed hundreds of thousands of new affordable homes, without a single association ever going into default with any of its lenders.

This is not the only approach that can be utilised, for example the Council will have an established approach to the setting of Prudential Indicators in the General Fund which it might wish to consider in the HRA context. However, as will be seen, looking at tried and tested principles from a privately financed sector in the HRA context provides a powerful and persuasive evidence base to provide for a significant increase in funding for new HRA developments.

5.2. Housing association metrics

Housing associations have traditionally been funded from long-term bank lending from the High Street banks and Building Societies. There is over £60billion of debt on HA balance sheets. Bank lending has been built on lending covenants which have become established in the marketplace and associated with the delivery of cheap debt. Whilst local authority borrowing is not directly secured on its asset base, the covenant approach provides a key insight into the viability and sustainability of borrowing as viewed by private lenders.

We have identified three covenants/ratios or metrics which we consider potentially relevant in the HRA context, set out below.

Interest Cover Ratio (ICR)

This is the ratio of operating surplus divided by interest costs, and represents the cover that the HRA has against its interest cost liabilities in any year; the ICR is set to a minimum which provides comfort that if there were a sudden drop in income or increase in operating costs, there would be sufficient headroom to continue to cover debt interest. For housing associations, the usual definition of operating surplus is EBITDA-MRI (Earnings before Interest, Tax, Depreciation and Appropriations – Major Repairs Included). The average ICR for the HA sector in 2019.20 was around 1.65; typical lending covenants vary between 1.10 and 1.50 depending on the size and nature of the HA, with 1.25 being a typical ”golden rule”.

For the HRA, operating surplus is best defined as:

- Turnover (dwelling rents, other rents, service charges, contributions)
  Less
- Operating Costs (general management, special management, other management, repairs & maintenance, major repairs)

For housing associations, depreciation is not a cash transaction. In the HRA, because of the treatment of depreciation as a cash transfer to the Major Repairs Reserve (MRR) plus an adjustment to reflect actual transfers to MRR, it is essential to include the net amount transferred to MRR in the calculation. This represents the revenue expenditure on major repairs made legitimately as part of operating costs. Notwithstanding that these are subsequently treated as part of the capital programme, they are funded from revenue and properly an operating cost. Whilst transfers to the MRR may not be spent in-year, our experience is that the majority of balances carried in the MRR tend to be from expenditure slippage.

The above definition of ICR works in the HRA context as it determines the revenue surplus before interest, appropriations, and other “below the line” adjustments, and already takes into account a significant element of costs relating to major repairs before comparing to debt interest capability.

Loan to Value (LTV)

This is an essential tool for private lenders where debt is secured against properties, hence theoretically against their value. The basis for valuation in HAs has been Existing Use Value (Social Housing) - EUV(SH) - for decades with many HAs and lenders now adopting Market Value Subject to Tenancy as a valuation method. Typical covenants prescribe 65-70% maximum LTV.

For the HRA, borrowing is not directly secured against the properties. In addition, the EUV(SH) calculation prescribed by government is not cashflow based, but is based on vacant possession values discounted by a regional factor periodically published by the government.

LTV is best defined in the HRA context as Outstanding Debt / Fixed Asset Value. Debt is defined as the HRACFR as this is the amount that must be financed with interest payments in the HRA. Asset values include all assets, dwellings and non-dwellings, as all assets are included in the generation of net income cashflows in the HRA.

Whilst the LTV definition works for the HRA to an extent, the absence of a clear relationship between net rental income and asset values means that the ratio tends to deliver a "low" result, compared to HAs.

Debt:Turnover ratio

Another measure we have developed for this analysis is the ratio of Debt to Turnover. This measures the level of turnover in relation to debt, which differs slightly from the ratio used for assessing debtor balances against turnover. As a proxy we have suggested a ratio of 5:0, so that turnover can cover the level of debt outstanding by a factor of 5 times. This measures the capability for gross income to cover debt and is becoming an established and readily accessible measure for local authorities.

Others

There are other covenants and ratios that are utilised in the HA context, including in particular Asset Cover (broadly, the inverse of LTV). Lenders and HAs are tending to move away from this towards gearing as a key measure.

Gearing is also another measure, which is effectively the LTV ratio but with the inclusion of reserves.

5.3. Using the metrics & benchmarking

The application of each metric to the cashflows and balance sheet within the business plan will result in a deemed maximum *constraint* on borrowing.

In the HRA context, the projected constraint on borrowing will operate separately because of the lack of direct dependency between net income streams and asset values and the level of debt. We would expect to see quite different results from each, and the extent to which the measures vary will offer additional insight into the viability and sustainability of new investment within the business plan.

The maximum capacity will result from the lowest outcome from each of the three metrics and each will change over time. A forecast for all three illustrates potential capacity frameworks for OCC, however we have proposed that the key focus might be on the Interest Cover Ratio as this provides the most straightforwardly interpreted and practical measure.

Savills has undertaken an analysis of the national position based on the HRA accounts for 2020.21. In additional we have used the same peer group as used for the cost benchmarking. OCC's outputs are compared below.

Table 5.1: metrics comparison to peer group and national average

Description	CBC Projections 2021.22	CBC Actual 2020.21	Peer Group 2020.21	National Actual 2019.20
Operating margin	26%	26%	28%	22%
Interest Cover Ratio	2.16	2.16	1.92	1.67
Loan to Value	25%	25%	34%	27%
Debt: Turnover	3.6	3.6	4.7	3.3

It is possible to draw general conclusions that:

- Interest cover remains greater than the peer group and the national position for 2019.20, however as per the benchmarking analysis we have commented on the lower level of depreciation charge which will influence by the operating margin and interest cover ratio.

  If we were to use the average depreciation value of the peer group the impact is shown below:
  - Operating Margin: 18%
  - Interest Cover Ratio: 1.46

- The loan to value is below both the peer group and the national average
- Debt to Turnover is also favourable in comparison to the peer group and national average
- In measures the performance between 2020.21 actuals and 2021.22 budgets remains static

5.4. Metrics for CBC HRA BP model

We have taken the outputs from the HRA Business Plan model and analysed the three metrics from the key financials of the modelling.

The three graphs below illustrate the metrics described in section 5.2

We have set minimum metrics as follows:
- ICR @ minimum 1.25
- LTV @ maximum 50%
- Debt:Turnover @ maximum 5.0

These are not minimum/maximum constraints, rather guidelines based on benchmarks within the HA sector and with other HRAs..

The Council may wish to operate with leeway within each.

It is emphasised that these are guideline measures to assist the central finance function (s151 officer) to determine what are prudent borrowing limits. Ultimately, the s151 is accountable for any specific borrowing is undertaken according to the principles of prudence in the Prudential Code.

The modelling has been amended to reflect the impact of a higher depreciation charge, based on the average derived from the peer group.

Chart 5.1– Interest Cover Ratio Projections

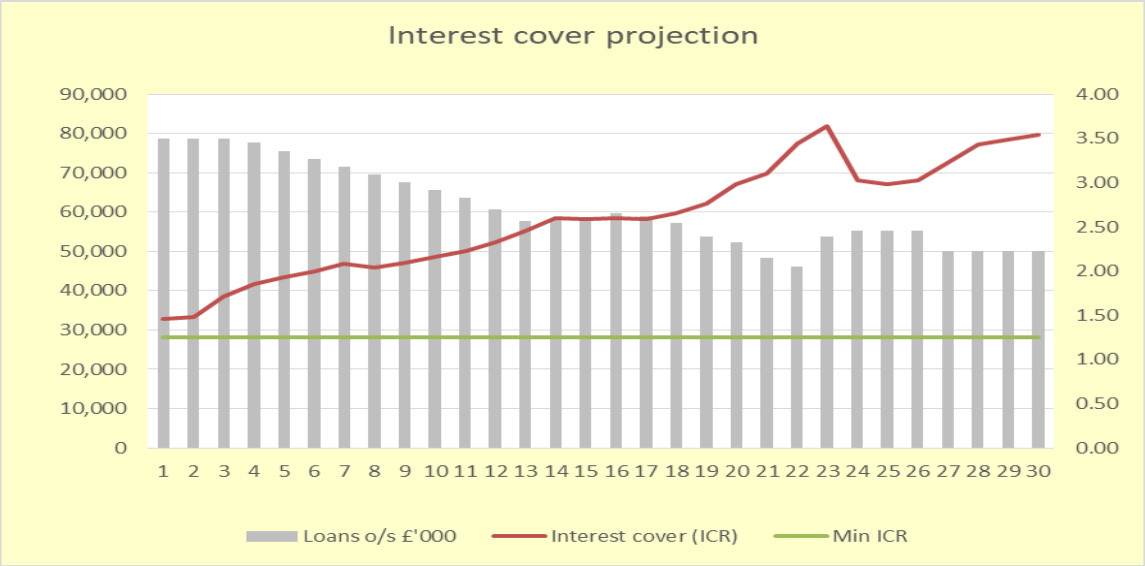


Chart 5.2 – Loan to Value Ratio Projections

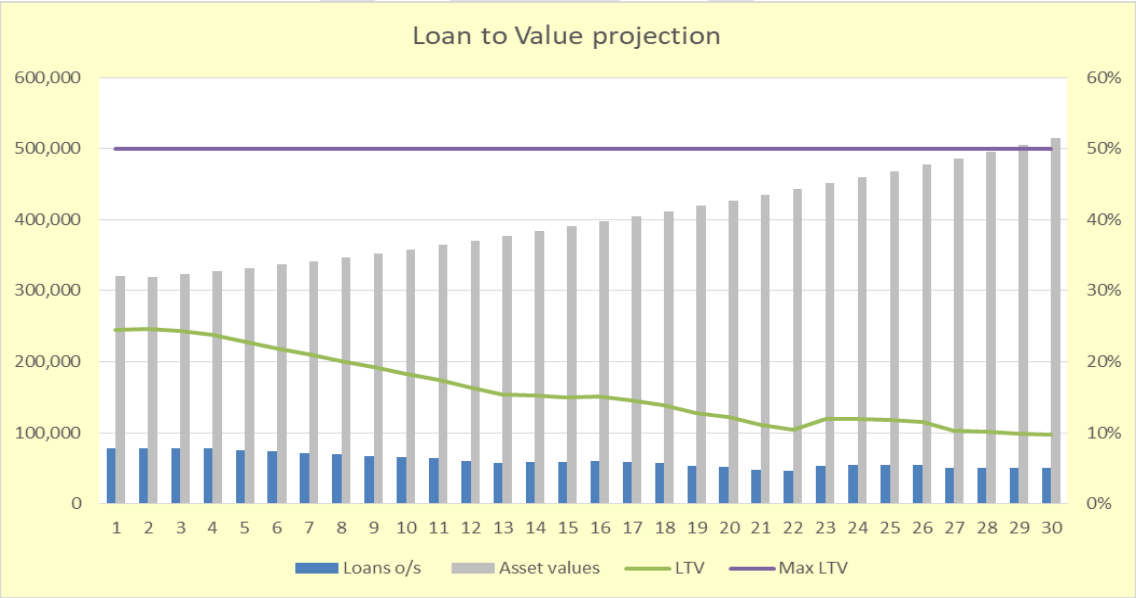
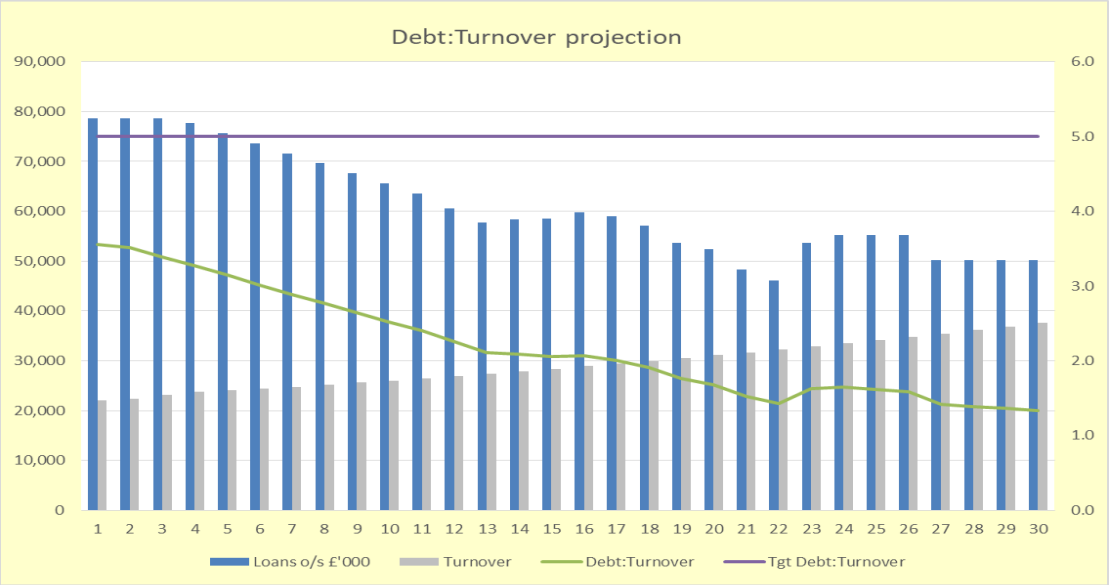


Chart 5.3 – Debt:Turnover Ratio Projections



The three graphs illustrate the following:

- The ICR shows that there is additional capacity available in all of the years and shows growth for the majority of these. Part of the reason will the net repayment of loans, thus reducing the levels of interest paid
- That there is the same direction of travel in terms of LTV but growth is extended by the repayment of loan maturing offset by refinancing and additional borrowing
- The Debt:Turnover ratio shows a similar pattern to the ICR

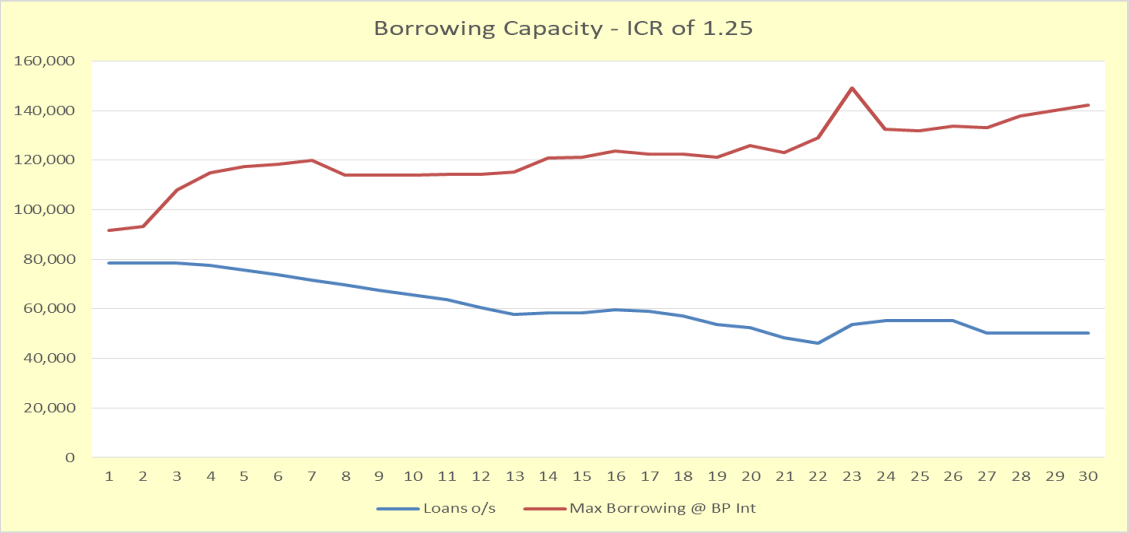
The interplay between these metrics illustrate the importance of adopting an overall approach to setting a framework, rather than relying on any specific measure or measures.

In particular, whilst interest cover remains broadly within expected limits in the early years and grows quickly for the remainder of the plan, highlighting the underlying strength of net cashflows in the current stock and due to net loan repayments.

5.5. Additional capacity over time

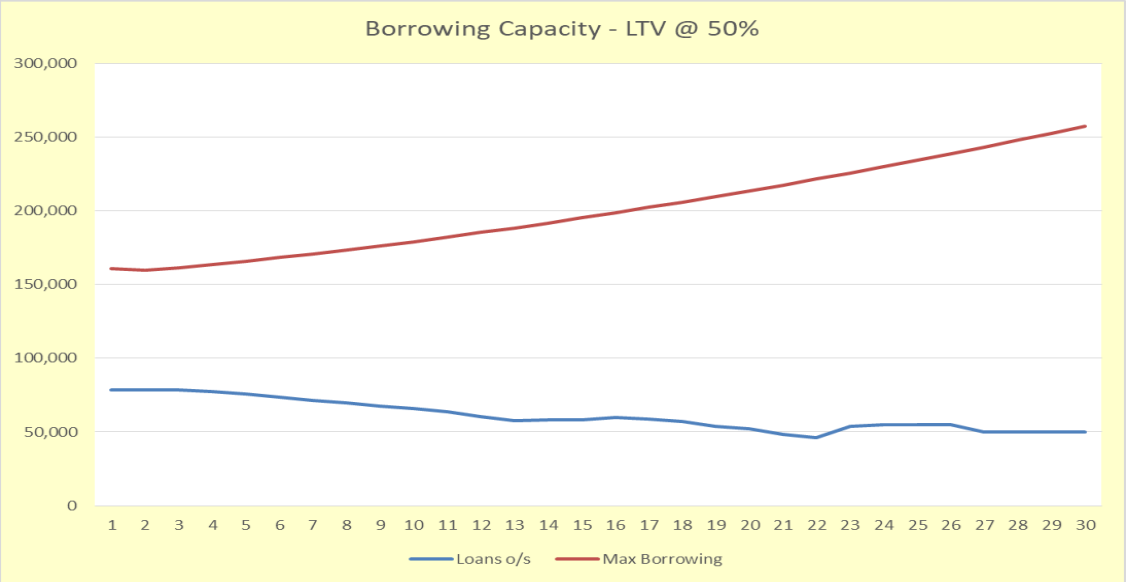
We have set out below our forecasts for how borrowing capacity changes during the term of the plan. These are based on the outputs from the charts 5.1 to 5.3 above.

Chart 5.4 – Forecast Debt Capacity based on a Minimum ICR of 1.25



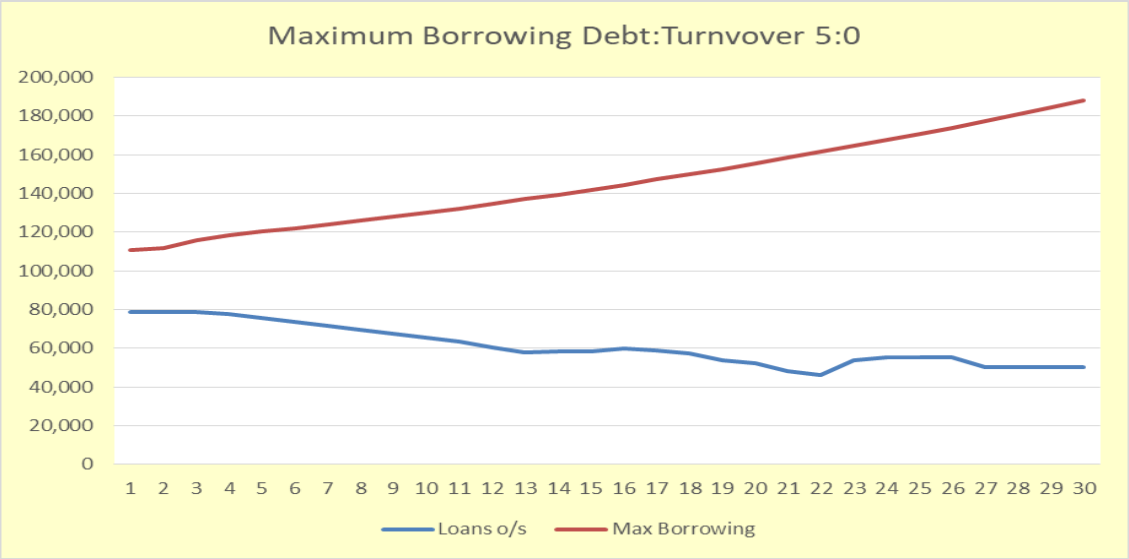
This chart demonstrates that capacity (the gap between the two lines) is available immediately of c£13.2million and steadily increasing.

Chart 5.5 – Forecast Debt Capacity based on a maximum Loan to Value Projection of 50%



The asset value is increasing over the years on account of the development programme, inflation but offset by right to buys. In all years there is borrowing capacity, which increases as net debt is repaid.

Chart 5.6 – Forecast Debt Capacity based on a maximum 5.0 Debt to Turnover Ratio



As set out above, this graph presents a similar position to the ICR metric demonstrating that capacity is increasing throughout the plan.

6. Sensitivity & Scenario Modelling

6.1. Sensitivity Testing

As part of the business planning process we have run a series of sensitivities to demonstrate the impact of changes to the assumptions used within the model and are shown in the table below:

Table 6.1: Sensitivity Test

Sensitivity £'m	HRA Bal Yr 10	HRA Debt Yr 10	ICR Yr 10	HRA Bal Yr 30	HRA Debt Yr 30	ICR Yr 30
Base	**6.718**	**65.620**	**2.16**	**17.805**	**50.157**	**3.55**
CPI -0.5%	6.051	65.620	2.04	13.177	53.509	2.85
CPI +0.5%	7.401	65.620	2.28	22.961	46.670	4.44
Int Rate +1%	6.718	65.620	2.16	15.023	52.085	2.82
Cap Exp +10%	0.760	65.620	2.16	9.975	78.757	2.26
Voids -1%	8.741	65.620	2.27	21.727	42.078	4.47
RTB Halved	10.655	65.620	2.49	31.471	29.893	7.72
Rents +1% all yrs	11.764	65.620	2.79	113.931	13.620	33.45
Rents CPI Only	1.442	65.620	1.92	10.267	73.508	2.12

The plan shows a resilience to changes but mostly impacts upon the resulting level of debt. Any changes to rent assumptions have the greatest impact.

6.2. Scenario Modelling (Sheltered Review)

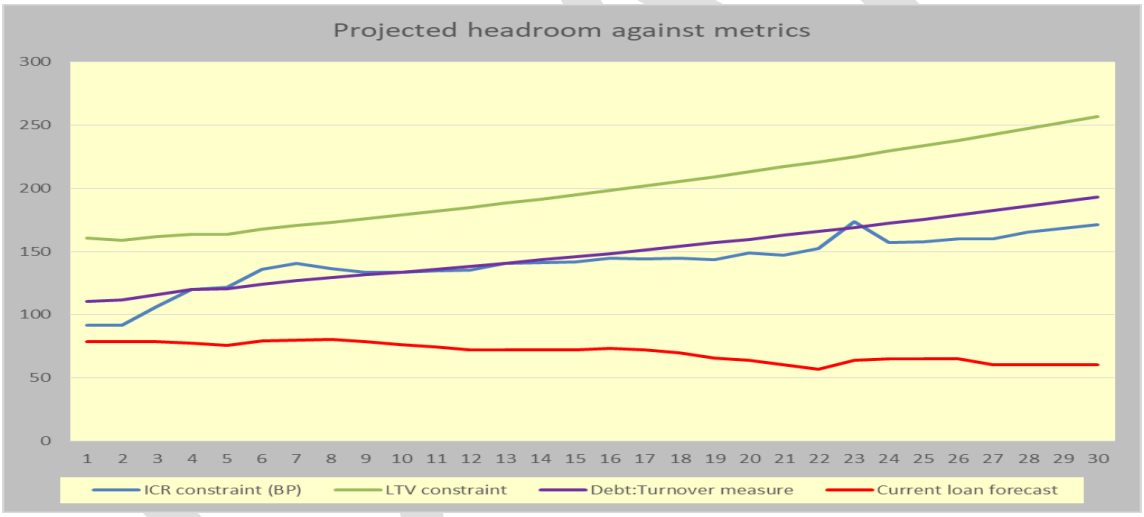
The result of the capacity analysis in section 5 has identified that the HRA has borrowing headroom if the metrics suggested are applied.

For example, if £17.5million was invested in the next five years in improving the sheltered accommodation over and above that allowed for within the existing levels provided for stock investment, the impact on the plan would be as follows.

Table 6.2: Impact of Sheltered Improvements Scenario

Scenario £'m	HRA Bal Yr 10	HRA Debt Yr 10	ICR Yr 10	HRA Bal Yr 30	HRA Debt Yr 30	ICR Yr 30
Base	**6.718**	**65.620**	**2.16**	**17.805**	**50.157**	**3.55**
Sheltered Improvements	2.018	76.481	2.17	21.414	60.091	2.56

Chart 6.1 Borrowing Capacity – Sheltered Improvements Scenario



With the projected level of borrowing required offset partially by the reduction in voids allowance for rents and service charges the result of the sheltered remodelling is not as significant as might have been expected. Whilst debt levels increase, there is a marginal increase to projected revenue balances.

In terms of borrowing capacity the ICR remains relatively static in the medium-term but as demonstrated in chart 6.1 there remains capacity with all metrics as presented.

6.3. Scenario Modelling (Continuation of Acquisitions)

Whilst CBC continues to sell properties through right to buys we have modelled the scenario of the continuation of open market acquisitions utilising the useable receipts to maximum effect.

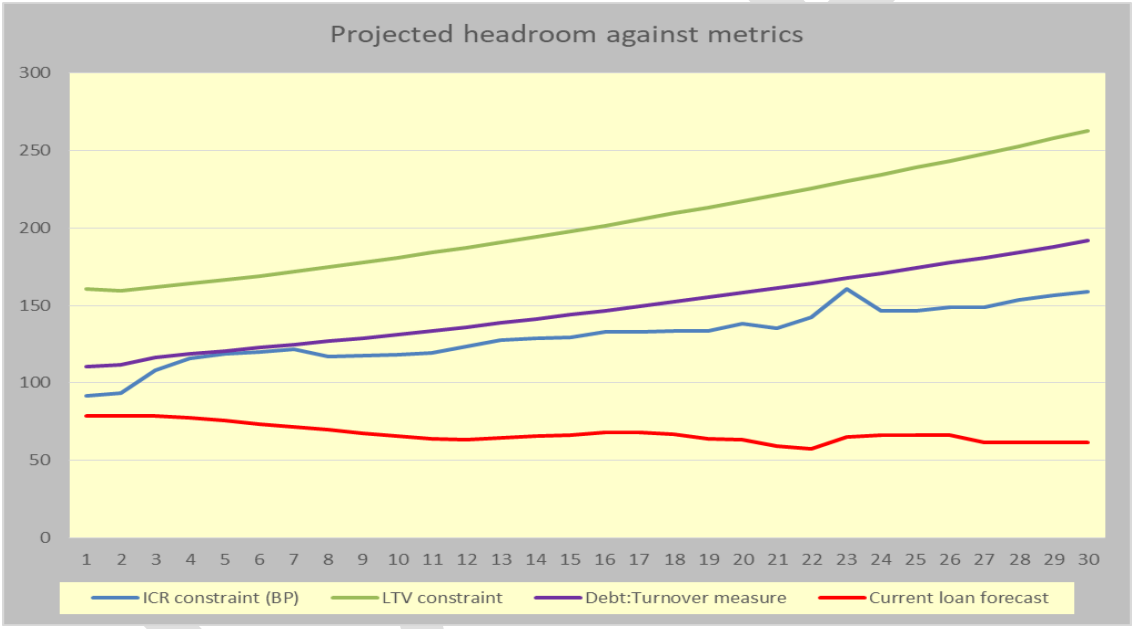
This scenario assumes that over the next 29 years an additional 108 properties will be acquired.

The results are as follows:

Table 6.3: Impact of Additional Acquisitions Scenario

Scenario £'m	HRA Bal Yr 10	HRA Debt Yr 10	ICR Yr 10	HRA Bal Yr 30	HRA Debt Yr 30	ICR Yr 30
Base	**6.718**	**65.620**	**2.16**	**17.805**	**50.157**	**3.55**
Additional Acquisitions	1.668	65.620	2.24	17.771	61.367	3.24

Chart 6.2 Borrowing Capacity – Additional Acquisitions Scenario



In order to facilitate the continuation of the acquisition programme additional borrowing is required in the longer-term and use of reserves in the shorter-term. Whilst the level of subsidy towards the acquisitions is modelled at 40% the levels of rent modelled demonstrate that the existing stock cashflows need to also provide a form of subsidy.

The result is additional debt to the plan with equivalent reserves projected.

In terms of borrowing capacity, as demonstrated in chart 6.2, there remains borrowing headroom throughout.

7. Summary

7.1 Our review has demonstrated that in overall terms CBC's operating and investment costs are within benchmarks for similar authorities HRAs.

7.2 This provides for an appropriate basis in which forecast the HRA business plan from.

7.3 The HRA business plan forecast as set out in our modelling for CBC has been refined to generate an analysis of future borrowing capacity.

7.4 We have defined three metrics or ratios to illustrate how a capacity framework might be developed to underpin future decision making in investment and borrowing strategies. Whilst based on the experiences of covenants in the housing association sector, these have been refined to reflect the particular accounting and funding issues applicable in the HRA.

7.5 Over the next few years the Council could borrow and use reserves in order to fund the required investment in the stock, supporting the draft Asset Management Strategy Framework, additional investment in its sheltered housing stock and fund further acquisitions.

7.6 The primary capacity constraint, therefore, within CBC's business plan is the Interest Cover Ratio, which measure the extent to which operating surpluses can cover debt interest payments and provide comfort against short-medium term reductions in income or increases in costs.

7.7 The Council can affect future operating surpluses through effective cost management and this would increase borrowing capacity. Similarly, increases in inflation and in particular in rent inflation would add significantly to future capacity

7.8 This review should provide a sound basis for the Council to inform its future approach to establishing a decision making framework for its HRA investment and development strategies, and also inform the work to be undertaken to adopt Prudential Indicators for the HRA. This needs to be set against the backdrop of considering the repayment of debt as it falls, the potential to use reserves rather than borrow to deliver the initial development programme and use of reserves to fund future developments rather than borrow. However, this needs to be considered in the context of CBC's treasury management strategy.

7.9 The business plan will continue to evolve as the Asset Management Strategy developments as to when the costs of zero-carbon are established, funding mechanisms available and budgetary changes.

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November 2021